Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Initiation of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1

REPLY COMMENTS OF SBC COMMUNICATIONS INC.

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SUMMARY

SBC Communications Inc. (SBC) hereby submits its reply comments in the Commission's cost review proceeding for the residential and single-line business subscriber line charge (SLC) cap.

In reviewing the price cap local exchange carriers' (LECs') cost submissions, it is important for the Commission to consider the broader context of this proceeding and the purpose and nature of the cost information that is being reviewed. A number of commenters reiterate the need for the Commission to proceed with the scheduled increases in the SLC cap mandated by the *CALLS Order* in order to reduce the reliance on implicit subsidies. The CALLS plan entailed a massive upfront reduction of approximately $3.4 billion in the years 2000-2001 by the price cap LECs, followed by a gradual transition to more direct recovery of interstate loop and port costs from end users. The purpose of the gradual increases in the primary residential and single-line business SLC cap is to reduce the significant implicit subsidies that remain in the system.

It also is important to remember what this proceeding is not. A number of commenters completely ignore the reform plan implemented by the Commission in the *CALLS Order*, as well as the nature and purpose of the cost information that is being reviewed. Instead, they call for full-blown cost studies and the type of painstaking Commission review that might be appropriate for a proceeding to establish prices in a rate of return environment, but is completely unnecessary here. Attempting to satisfy these demands would place an incredible burden on the Commission's and the price cap LECs' resources with no corresponding benefits. Contrary to these arguments, SBC's forward-looking cost submission is consistent with the commitment made by the members of CALLS and the Commission's Public Notice. A number of

commenters also note that the Commission is not limited to considering the cost information submitted by the price cap LECs.

A number of commenters criticize SBC's cost submission on the grounds that it does not calculate forward-looking costs. That is not true. As SBC explained, its cost studies are "forward-looking." They use the latest plant technology for the components of the network, while also taking into account characteristics of the actual network, such as locations of central offices and customer premises. Several commenters mistakenly assume that a methodology must rely on assumptions of hypothetical network equipment and characteristics in order to be forward looking. From this faulty logic, they argue that the Commission's TELRIC methodology from the interconnection proceeding or its Synthesis Model from the universal service proceeding must be used to establish the primary residential and single-line business SLC cap. In addition, several commenters raise specific issues related to the assumptions and inputs used in SBC's cost submission. Criticisms of SBC's methodology for calculating fill factors, common costs, costs of capital and use of proxy information are unfounded.

Finally, NASUCA devotes a significant portion of its comments to discussing cost allocation issues that clearly are beyond the scope of this proceeding. The sweeping rule changes requested by NASUCA are both unnecessary and irrelevant to the issue of whether the primary residential and single-line business SLC cap should be increased.

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REPLY COMMENTS OF SBC COMMUNICATIONS INC.

SBC Communications Inc. (SBC) hereby submits its reply comments in the Commission's cost review proceeding for the residential and single-line business subscriber line charge (SLC) cap.[1]

A number of commenters acknowledge that the current SLC caps continue to produce implicit subsidies flowing from access charges and multi-line business charges to residential and single-line business charges, as well as from low-cost unbundled network element (UNE) zones to high-cost UNE zones. These commenters express support for the Commission to proceed with the scheduled increase in the residential and single-line business SLC cap above $5.00. SBC agrees that the Commission has more than sufficient cost information to leave its current rules in place and reduce the longstanding reliance on implicit subsidies to support prices for local residential services.

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[1] *Initiation of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps*, CC Docket Nos. 96-262, 94-1, Public Notice, DA 01-2163 (rel. Sept. 17, 2001).

Those commenters who oppose increasing the SLC cap completely ignore the context and limited purpose of the Commission's cost review proceeding. In effect, they are demanding that the Commission conduct this proceeding as if it were a rate of return ratemaking proceeding in which the price cap local exchange carriers (LECs) must support their rates with full-blown cost studies. Moreover, at the same time these commenters are arguing for detailed cost study information, they take the contrary position that the SLC cap should be determined based on the averaged costs of a hypothetical super-efficient network, rather than the costs of the price cap LECs' actual forward-looking network equipment and design. Several commenters also raise a number of baseless criticisms about SBC's cost submission and seek to introduce arguments about the Commission's cost allocation rules that have nothing to do with the issues in this proceeding. Ultimately, these commenters cannot avoid the overwhelming evidence that supports allowing the scheduled increases in the residential and single-line business SLC caps to take place.

I. THE COMMISSION MUST CONSIDER THE BROADER CONTEXT OF THE CALLS PLAN AND THE PURPOSE AND NATURE OF THE COST INFORMATION THAT IS BEING REVIEWED

In reviewing the price cap LECs' cost submissions, it is important for the Commission to consider the broader context of this proceeding and the need for the Commission to proceed with the scheduled increases in the SLC cap mandated by the *CALLS Order*[2] in order to reduce the reliance on implicit subsidies. But it also is important to remember what this proceeding is not. A number of commenters completely ignore the nature and purpose of the cost information that is being reviewed and the fact that an important component of the CALLS plan is to transition

[2] *Access Charge Reform et al.*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249 and Eleventh Report and Order in CC Docket No. 96-45, 12 FCC Rcd 15982 (1997) (*CALLS Order*).

from implicit subsidies to explicit universal service support. Instead, they call for full-blown cost studies and the type of painstaking Commission review that might be appropriate for a proceeding to establish prices in a rate of return environment, but is completely unnecessary here. Attempting to satisfy these demands would place an incredible burden on the Commission's and the price cap LECs' resources with no corresponding benefits.

A. Increases in the SLC Cap Are Needed to Reduce the Reliance on Implicit Subsidies

In the *CALLS Order*, the Commission concluded that the rate restructuring provided for in the CALLS plan serves the public interest "because it simplifies the current rate structure, moves toward cost-based rates, reduces consumers' overall rates, and simplifies long distance bills, thereby resulting in less consumer confusion."[3] The Commission's restructuring plan entailed a massive upfront reduction of more than $2 billion by the price cap LECs, followed by a gradual transition to more direct recovery of interstate loop and port costs from end users. The purpose of the gradual increases in the primary residential and single-line business SLC cap is to reduce the significant implicit subsidies that remain in the system.

In many cases, multi-line business customers subsidize primary residential and single-line business customers by continuing to pay a multi-line business PICC and by paying a SLC that may be as large as $9.20.[4] GSA notes in its comments that primary residential and single-line business customers benefited immediately from the elimination of the PICC and the reduction of their long distance charges, while business multi-line customers have continued to bear much higher costs as a result of the multi-line business SLC and PICC.[5] For business

[3] *Id.* at ¶ 81.

[4] 47 C.F.R. § 69.152(k)(1)(i).

[5] GSA Comments at 3.

customers such as GSA, the resulting subsidy payments are significant.[6] The scheduled increases in the primary residential and single-line business SLC cap are critical to reducing the subsidies embedded in the price cap LECs' multi-line business prices. NASUCA's assertion that primary residential and single-line customers are subsidizing multi-line business customers,[7] which is based solely on its flawed cost methodology, conveniently ignores almost twenty years of history in which prices paid by long distance carriers and business customers have been used to subsidize residential customers.

Moreover, as SBC explained in its cost submission, the current $5.00 primary residential and single-line business SLC cap impedes price cap LECs' ability to implement deaveraged SLCs in different UNE zones. The Commission has recognized the benefits that deaveraged rates will have in promoting competition and efficiency by removing implicit subsidies.[8] Therefore, SBC agrees with WorldCom that the Commission should consider the fact that the scheduled increases in the primary residential and single-line business SLC cap are both appropriate and necessary to achieve the goal of phasing out implicit subsidies, consistent with the *CALLS Order* and Section 254 of the Act.[9]

Several commenters argue that the Commission should take other steps to eliminate implicit subsidies. SBC opposes Ad Hoc's proposal to modify the existing rules to combine the multi-line business PICC with the multi-line business SLC.[10] This proposal, which the

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[6] *Id.* at 4.

[7] NASUCA Comments at 43.

[8] *CALLS Order* at ¶ 114.

[9] WorldCom Comments at 4.

[10] Ad Hoc Comments at 21-24.

Commission previously rejected, would exacerbate the distortions in the highly competitive business market by artificially inflating the price cap LECs' prices with implicit subsidies, which would competitively disadvantage price cap LECs and further encourage cherry-picking by competitive providers that generally do not charge SLCs. Any concern that Ad Hoc has about long distance carriers passing through inflated PICCs should be addressed directly with the carriers involved, as the Commission is doing with universal service contribution and recovery issues. The best way to reduce the burden of implicit subsidies borne by multi-line business customers is to allow the primary residential and single-line business SLC cap to increase so that recovery can be allocated fairly among all categories of lines.

B. The Commission's Cost Review Proceeding Is Not a Ratemaking Proceeding

It was in this context of a gradual transition plan to phase out implicit subsidies that the Commission agreed to review increases in the primary residential and single-line business SLC cap above $5.00.[11] The Commission's review actually was triggered by the commitment of SBC and other CALLS members to provide the Commission with "economic data, including data identifying the forward-looking costs associated with the provision of retail voice grade access to the public switched telephone network for those areas."[12] The Commission expressly rejected proposals to require a cost study prior to adopting the CALLS plan because it did not want to delay the immediate savings end users would realize from implementation of the plan.[13] In

[11] *CALLS Order* at ¶ 83.

[12] *Id.*

[13] *Id.* at ¶ 84.

addition, WorldCom correctly notes that the Commission did not adopt a forward-looking cost standard or establish a standard for reviewing the scheduled increase in the SLC cap.[14]

A number of parties completely ignore the context of this cost review proceeding. They argue that the price cap LECs should have submitted full-blown cost studies.[15] In addition, they argue that the Commission should review these cost studies as if this were a rate of return ratemaking proceeding. SBC has fully complied with its commitment to provide the Commission with economic data that identifies the forward-looking cost of providing retail voice grade access to the telephone network, and it did so on a deaveraged basis. In any event, the level of detail demanded by these commenters is totally unnecessary for the Commission to conduct its cost review and verify the reasonableness of the pricing and universal service reforms adopted in the *CALLS Order*.[16]

The limited cost review proceeding initiated by the Commission makes complete sense, given the structure of common line charges under the CALLS plan. The cost review proceeding relates solely to the nationwide cap on the primary residential and single-line business SLC, *not* the calculation of an individual price cap LEC's SLC.[17] As SBC discussed in its initial cost

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[14] WorldCom Comments at 3.

[15] NASUCA Comments at 17-27; California Public Utilities Commission (CPUC) Comments at 5-6. As discussed below, it would not be appropriate for SBC to have simply filed its state-approved UNE cost studies in this proceeding because the TELRIC methodology used to price wholesale UNEs is not appropriate for verifying the reasonableness of retail prices.

[16] The type of detailed cost study data demanded by a few commenters would require disclosure of competitively sensitive proprietary information regarding SBC's vendor relationships and procurement costs that is not publicly available.

[17] For example, the CPUC acknowledges that SBC's cost submission is not being used to justify a SLC increase in California at this time. Post-CALLS, SBC has never charged a Primary Residential or Single-Line Business SLC above $4.40 in California. The April 2000 data referenced by the CPUC in its comments was provided in order to illustrate the calculation of the

submission, the maximum primary residential and single-line business SLC will continue to be capped at the *lower* of the SLC cap or the average price cap common line, marketing and transport interconnection charge (CMT) revenue per line.[18] Common line recovery also is limited to the average CMT per line multiplied by the total number of access lines. There are additional price cap limitations on SLCs, such as the rule that residential SLCs cannot be used for business line recovery and the rule that total study area SLC revenues generated by deaveraged SLCs cannot exceed study area SLC revenue generated by multiplying total lines by average CMT revenue per line in that study area. Given the nature of the cap, the fact that there are *any* UNE zones where a price cap LEC's interstate local loop and port costs are above the current primary residential and single-line business SLC cap is sufficient to justify raising the cap.[19]

Further, for more than a decade, the large LECs' recovery of interstate common line costs has been governed by the Commission's price cap regime. Under price cap regulation, LECs have been required to pass on efficiency gains through the application of the productivity factor to price cap basket revenues.[20] This requirement also applies to common line basket revenues, which currently are generated by the SLC, PICC and CCL elements. Price cap LECs are permitted to retain any additional efficiency gains that exceed the nationwide productivity factor

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SLC under the Commission's price-cap rules. CPUC Comments at n.8. That data is not comparable to SBC's forward-looking cost data filed in this proceeding

[18] 47 C.F.R. § 69.152(d)(ii).

[19] Indeed, even NASUCA's grossly understated cost study demonstrates that 23% to 35% of customers nationwide are located in UNE zones where SLC costs the interstate portion of loop costs exceeds $5.00. Accordingly, there can be no doubt that the scheduled increases in the primary residential and single-line business SLC cap are warranted.

[20] Application of the productivity factor to price cap basket revenues has reduced these revenues in every annual filing since the price cap regime was established.

and thus are "incented" to become more efficient. The scheduled increases in the primary residential and single-line business SLC required by the *CALLS Order* are designed to achieve the next step toward a greater level of economic efficiency by beginning to replace implicit subsidies in carrier access charges with explicit recovery.

NASUCA's comments completely ignore the benefits that price cap regulation has afforded consumers and seek to turn the price cap regime on its head by imposing a rate of return type ratemaking methodology on the SLC. This approach is fundamentally inconsistent with the price cap refinements adopted by the Commission in the CALLS plan. The Commission did not suddenly re-institute a rate of return regulatory regime merely by asking for cost information to verify the reasonableness of the rules adopted in the *CALLS Order*. More importantly, unlike a rate of return ratemaking proceeding, the price cap LECs do not have the burden of proving that the Commission should maintain its existing rules that provide for gradual increases in the primary residential and single-line business SLC cap.

II. SBC's Cost Submission Uses the Correct Forward-Looking Methodology to Calculate Its Loop and Port Costs

A number of commenters criticize SBC's cost submission on the grounds that it does not calculate forward-looking costs.[21] That is not true. SBC properly performed cost studies to calculate the "direct forward-looking average recurring Long Run Incremental Cost (LRIC) for SBC to provide the facilities between SBC central offices and the customer premises that provide telephone service for residential and single-line business customers."[22] A forward-looking cost study assumes the deployment of technologies that are currently available in the market and for

[21] NASUCA Comments at 18; WorldCom Comments at 8.

[22] *See* SBC Overview of the Cost Studies Conducted for the FCC Subscriber Line Charge Proceeding, at 4 (Nov. 16, 2001) (SBC Cost Study Overview).

which vendor prices can be obtained. At the same time, the technology choices in a forward-looking cost study must be consistent with a carrier's overall network design requirements.

As SBC explained, its cost studies are "forward-looking." They assumed the latest plant technology for the components of the network, while also taking into account characteristics of the actual network, such as locations of central offices and customer premises.[23] For example, SBC assumed that fiber-fed digital loop carrier (DLC) systems would be deployed for loops greater than a copper/fiber crossover point when developing loop costs, and it assumed the ubiquitous deployment of digital switches when developing switching costs. These assumptions result in a substantially higher number of loops assumed to be on fiber than actually are on fiber in SBC's network. Further, SBC's loop cost development assumed the use of integrated digital loop carrier (IDLC) for a percentage of loops, but it did not assume ubiquitous deployment of IDLC. As discussed further below, SBC must maintain a large percentage of its plant in a universal digital loop carrier (UDLC) configuration due to economic and technical considerations.

In addition, SBC's cost studies assumed plant cost data, capital cost factors and operating expenses that are appropriate for these forward-looking technologies.[24] Because the cost studies incorporated SBC's current contract costs for the latest plant technology, they incorporated all of the benefits of SBC's economies of scale. At the same time, the cost studies did not factor in the substantial investment that SBC has made in developing and improving technology for its network. Thus, SBC's forward-looking cost methodology significantly understates its actual loop and port costs.

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[23] *Id.*

[24] *Id.*

Several commenters mistakenly assume that a methodology must rely on assumptions of hypothetical network equipment and characteristics in order to be forward looking. From this faulty logic, they argue that the Commission's TELRIC methodology from the interconnection proceeding or its Synthesis Model from the universal service proceeding must be used to establish the primary residential and single-line business SLC cap. Neither of these methodologies would be appropriate for the Commission's cost review in this proceeding. The Commission has used its TELRIC methodology to establish artificially low wholesale prices for UNEs and interconnection in order to encourage competitive entry. The Commission has never sought to use TELRIC to establish prices for retail services. Indeed, TELRIC excludes marketing and other costs associated with a retail service that are appropriately recovered as part of a price cap LEC's primary residential and single-line business SLC. Further, TELRIC, as defined by the Commission and implemented by the states, sets prices by projecting the forward-looking costs of a hypothetical carrier that always uses the most up-to-date technology and the most efficient network configuration.[25] At the same time, the Commission makes the contradictory assumption that the cost of capital should be the same as in the stable, low-risk monopoly system of the past.[26] All of these assumptions are designed to produce the lowest possible wholesale prices for UNEs and interconnection. Thus, it would not be appropriate for

[25] *In the Matter of Telecommunications Act of 1996: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket Nos. 96-98 and 95-185, First Report and Order, 11 FCC Rcd 15499, ¶¶ 679, 683-85 (1996*) (Local Competition Order), aff'd in part and rev'd in part Iowa Utils Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997*), aff'd in part and rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999).

[26] *Id.* at ¶¶ 687-88, 702.

the Commission to rely on UNE cost studies to review the reasonableness of the SLC in this proceeding.[27]

The Commission has applied its Synthesis Model in the universal service proceeding to establish statewide average costs for purposes of calculating and allocating universal service funding. To that end, the federal universal service high cost fund mechanism relies on a cost benchmark, rather than pricing (or revenues). As NASUCA itself acknowledges, the purpose of the Synthesis Model is not to attempt to identify any particular carrier's costs of providing service, but rather to estimate the costs that an efficient provider would incur in providing service.[28] The Synthesis Model also utilizes a hypothetical network approach that is similar to TELRIC. In other words, the Synthesis Model relies on statewide average data, for a hypothetical network rather than company-specific data, to reduce the administrative burden of managing the federal universal service fund. NASUCA's attempt to rely on the Synthesis Model contravenes the Commission's explicit warning to not rely on the input values it produces in other proceedings.[29] Therefore, neither methodology is an appropriate point of comparison for the price cap LECs' primary residential and single-line business SLC.

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[27] *See* CPUC Comments at 13.

[28] NASUCA Comments at 20 (*citing Federal-State Joint Board on Universal Service and Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45 and 97-160, Tenth Report and Order, 14 FCC Rcd 20156 (1999)).

[29] In the *Tenth Report and Order*, for example, the Commission stated that the Synthesis Model was developed "for the purpose of determining federal universal service support, and it may not be appropriate to use nationwide values for other purposes, such as determining prices for unbundled network elements. We caution parties from making any claims in other proceedings based upon the input values we adopt in this Order." *Tenth Report and Order* at ¶ 32; *see also Application of Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distasnce), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions) and Verizon Global Networks Inc., for Authorization. to Provide In-Region, InterLATA Services in Massachusetts*, CC Docket No. 01-9, Memorandum Opinion and Order, 16 FCC Rcd 9899 ¶ 32

Not only does NASUCA err in utilizing the Synthesis Model, but it also modifies the Synthesis Model to further understate the price cap LECs' costs. The most egregious example is NASUCA's treatment of next generation DLC equipment and feeder plant costs. NASUCA first criticizes SBC for assuming that UDLC will be deployed in parts of its network, rather than assuming that IDLC could be exclusively deployed in the network.[30] This assumption ignores the fact that IDLC deployment would not be cost-effective to deploy throughout the entire network and is not technically capable of accommodating interconnection with other carriers. But NASUCA does not stop at making impossible assumptions about the use of IDLC – it then simply excludes the entire cost of the feeder portion of the loop on the grounds that it is traffic sensitive.[31] NASUCA's assumption is completely contrary to the uniform decision of state commissions to require flat-rated recovery of feeder plant, and it also contradicts the Commission's holding that both feeder and distribution plant are excluded from traffic-sensitive reciprocal compensation charges.[32] NASUCA cannot simply assume away the realities of the existing regulatory framework and cost recovery structure in this manner. In addition to making outrageous assumptions that understate costs, NASUCA carefully avoids identifying the cumulative effect of scenarios that result in an upward adjustment of costs (*e.g.*, cost of capital, depreciation and loop length), while simultaneously evaluating the cumulative effect of scenarios that reduce costs. The net result is a one-sided analysis that does not accurately reflect the price cap LECs' forward-looking costs.

(2001) ("The [Synthesis Model] was designed to determine relative cost differences among different states, not actual costs.").

[30] *Id.* at 31.

[31] *Id.* at 44.

[32] *Local Competition Order* at ¶ 1057.

Even if the Commission were to compare the price cap LECs' costs to the existing SLC cap using TELRIC or the Synthesis Model, it would still have to conclude that an increase in the SLC cap is warranted. NASUCA's own study shows that 23% to 35% of customers nationwide are located in UNE zones where SLC costs are above the existing $5.00 cap.[33] Likewise, Ad Hoc's comments demonstrate that an increase in the SLC cap is justified by various cost data, including ARMIS data for access line costs, outputs from the Synthesis Model for loop and port costs, and the results of TELRIC studies adopted by state commissions.[34] Thus, commenters simply cannot avoid the overwhelming evidence that the scheduled increases in the primary residential and single-line business SLC cap are warranted.

III. SBC'S COST SUBMISSION UTILIZES REASONABLE ASSUMPTIONS AND INPUTS

The deaveraged cost information that SBC submitted was calculated utilizing the appropriate forward-looking cost methodology with reasonable assumptions and inputs. Not surprisingly, several commenters raise specific issues related to the assumptions and inputs used in SBC's cost submission in an attempt to undermine the results. While SBC believes that a full review of its cost studies is unnecessary, the following are SBC responses to these specific criticisms:

Fill Factors. NASUCA criticizes SBC for using actual fill factors because it claims fill factors will increase over time.[35] There is no basis for assuming that fill factors will increase dramatically over time. SBC's recent experience is that access lines are fairly stable and are not fluctuating widely. If anything, SBC and other incumbent LECs face access line losses that may

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[33] NASUCA Comments at 25-26.

[34] Ad Hoc Comments at 10-17.

[35] NASUCA Comments at 32.

contribute to lower fill factors in the future. Therefore, SBC's reasonably assumed that the most accurate prediction of forward-looking fill factors is the current actual fill factors.

Consistent with standard engineering practices, SBC's fill factors include some additional capacity to account for future growth needs. The level of fill in SBC's outside plant reflects the reality that it must live within real-world constraints, while also providing quality service as economically as possible. Two factors have the largest impact on fill factors. First, the costs of reinforcing outside plant are substantially higher, at least an order of magnitude higher, than the costs of placing extra capacity at initial build-out. SBC does not have any incentive to overbuild plant in a price cap regime, so its decisions are driven by a desire to operate cost effectively. Second, as the incumbent LEC, SBC is obligated to provide service in a timely manner to every customer or face severe financial penalties. It would be inappropriate to ignore SBC's regulatory mandates in considering the appropriate forward-looking fill factors.

SBC's actual fill factors represent the culmination of years of experience of providing high quality, cost-efficient service. The existing network is the result of a constant balancing act of spending enough budget money on extra capacity to provide good quality service and avoid performing too many reinforcement jobs. NASUCA's vague criticism fails to explain why SBC's fill factors are unreasonable. To the extent NASUCA relies on fill factors from the Synthesis Model, it has incorrectly relied on hypothetical assumptions that the Commission has stressed are for comparative purposes only and should not be used as actual cost inputs.

Common Costs. SBC's methodology for calculating the common costs factor used in this proceeding was done by determining the level of common costs appropriate for the level of investment in subscriber line equipment. NASUCA criticizes SBC's calculation of common costs such as customer service costs, call completion costs, marketing costs and taxes.[36] Contrary to NASUCA's assertion, SBC is not double recovering connection and disconnection costs.[37] The call completion account contains the "expenses incurred in helping customers place and complete calls, except directory assistance." For example, the costs of handling and recording, quoting rates and other related activities are involved in the manual handling of calls. The interstate call completion costs included in this study are not recovered by any other charge.

NASUCA's argument that the Commission should exclude marketing costs effectively constitutes an untimely petition for reconsideration of the *CALLS Order*, which expressly includes marketing costs in the price cap LECs' SLC recovery.[38] In any event, SBC's efforts to ensure that customers are aware of its full line of products and services are an important part of customer retention in today's competitive environment.

NASUCA also claims that SBC has improperly included "state regulatory fees" in its study by including costs from the Operating Other Taxes account.[39] This argument ignores the fact that the Operating Other Taxes account is comprised almost entirely of property taxes. Contrary to NASUCA's claim, SBC properly apportioned costs in the Operating Other Taxes account on the basis of the separation of costs and included interstate costs in its study that are not recovered by any other charge.

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[36] *Id.* at 29, 33-37.

[37] *Id.* at 29.

[38] *Id.* at 35.

[39] *Id.* at 29.

Cost of Capital. NASUCA attempts to create confusion about the cost of capital used in SBC's studies by citing its use of an 11.25% rate of return in the common costs methodology.[40] Contrary to NASUCA's assertion, SBC did not infer that it believes 11.25% is its cost of capital. SBC clearly stated that its studies reflect the company's actual cost of capital, taking into account its expected rate of return on investments and the opportunities and risks the company experiences within its industry. It was clearly appropriate for SBC to make that assumption. In the one instance where SBC utilized the Commission's 11.25% rate of return, rather than the company's actual cost of capital, it clearly noted that fact in its cost submission. It should be noted that SBC's use of an 11.25% rate of return in the shared and common costs understates its costs and thus does not support NASUCA's position in this proceeding.

Use of Proxy Information. NASUCA criticizes SBC for using proxy information for certain installed cable and outside plant components.[41] SBC's use of proxy information was limited and based on reasonable assumptions. Because SBC is a large purchaser of plant equipment, it receives very favorable terms for its purchases of outside plant materials such as copper cabling. SBC's cost studies reflect these favorable terms, which are similar for all thirteen states. Installation costs do sometimes vary across different states, but SBC minimized that variation by considering the similarity of geographic areas when using proxy information. For example, California and Texas are both large, highly populated states with several very large cities, desert regions, mountainous regions and substantial coastlines, hence Texas data is a reasonable proxy for California data. SBC's reasonable approach stands in contrast to

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[40] *Id.* at 27.

[41] *Id.* at 30.

NASUCA's attempt to characterize the use of nearly *every* input in its study as representative of every carriers' costs, which is patently unreasonable.

IV. THE COMMISSION SHOULD NOT RECONSIDER ITS COST ALLOCATION RULES, PARTICULARLY IN THE CONTEXT OF THIS PROCEEDING

NASUCA devotes a significant portion of its comments to discussing cost allocation issues that clearly are beyond the scope of this proceeding. The sweeping rule changes requested by NASUCA are both unnecessary and irrelevant to the issue of whether the primary residential and single-line business SLC cap should be increased. NASUCA's primary rationale for introducing cost allocation issues in this proceeding is that the cost studies submitted by the price cap LECs in this proceeding are "biased upward" due to their investment in facilities used for data traffic.[42] That statement is wrong with respect to SBC's cost study. SBC's cost study is limited to the costs associated with delivering voice traffic to primary residential and single-line business customers and does not include costs associated with data traffic.

There are no other justifications for the Commission to replace its existing cost allocation rules with the type of burdensome requirements proposed by NASUCA. Applying a "one-size-fits-all" cost allocation rule, as advocated by NASUCA,[43] would not drive costs in a manner that is consistent with individual markets, specific system architectures and regional variations in the costs of material and labor resources. Moreover, the presence of price caps without a sharing mechanism provides a compelling justification for *reducing*, rather than dramatically increasing, the scope of the Commission's cost allocation rules. The *CALLS Order* changed the SLC pricing methodology from interstate accounting costs to CMT revenue per line and gradually increased the SLC cap above $3.50. As a result, the 1999 Annual Price Cap Filing was the last time SLCs

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[42] *Id.* at 61.

[43] *Id.* at 98.

were based on interstate accounting costs. The common line revenue generated by the 1999 Annual Price Cap Filing prices was the primary input for the average CMT per line, which was used to establish the SLCs in the 2000 Annual Price Cap Filing as required by the *CALLS Order*. Because a price cap LEC's SLC prices are based on average CMT revenue per line and overall common line basket revenues are capped, there is no danger that a price cap LEC will be able to cross-subsidize its advanced services deployment by improperly shifting the costs of such deployment to the SLC. Thus, the Commission's existing safeguards are more than sufficient to ensure that local voice customers are not cross-subsidizing advanced services.

NASUCA's statutory argument that Section 254(k) requires an allocation of loop costs to advanced services is equally unavailing. As NASUCA acknowledges, it raised a similar cost allocation argument earlier in the CALLS proceeding. The Commission rejected NASUCA's argument in the *CALLS Order*, concluding that "there is no legal impediment to a federal recovery mechanism that simply requires all telephone subscribers to pay, on a per-line basis, for that portion of their *necessarily-incurred* local telephone plant costs that is assigned to the interstate jurisdiction."[44] The Commission correctly interpreted Section 254(k) as a requirement to prevent price cap LECs from over-allocating costs to supported services and to ensure the proper treatment of joint and common costs through its accounting, cost allocation, separation and access charge rules.[45] The Fifth Circuit subsequently rejected NASUCA's appeal of this issue and affirmed that the Commission's restructuring of the SLC is consistent with Section 254(k).[46]

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[44] *CALLS Order* at ¶ 93.

[45] *Id.* at ¶ 96.

[46] *Texas Office of Pub. Util. Counsel et al. v. FCC*, 265 F.3d 313 (5th Cir. 2001). NASUCA has filed a petition for certiorari seeking Supreme Court review of the Fifth Circuit's decision.

Having failed in its challenge of the *CALLS Order*, NASUCA is now seeking broad-based changes to the Commission's cost allocation rules in this proceeding. There is no reason why the Commission should adopt additional regulations in this area. Replacing the current rules with NASUCA's proposed rigid rule to split the costs of loops that jointly provide voice service and advanced services would lead to an endless regulatory proceeding in which the Commission would be forced to micromanage the price cap LECs' networks and their deployment of advanced services.[47] Moreover, given the small percentage of residential customers who actually are purchasing advanced services, such a proceeding would not result in any significant costs being reallocated.

An important factor in the Commission's consideration of whether to proceed down this regulatory path is the statutory goal of promoting the deployment of advanced services. In Section 706 of the Telecommunications Act of 1996, Congress explicitly directed the Commission to "encourage the deployment of broadband services through regulatory forbearance and other measures that "remove barriers to infrastructure investment."[48] Creating an entirely new set of cost allocation rules for the price cap LECs' provision of advanced services is the opposite of what Congress had in mind. It is ironic that NASUCA would cite the video dialtone proceeding as a model for potential Commission action on advanced services[49] – it actually is a prime example of how burdensome cost allocation rules can ensure that new services never get off the ground. After years of contentious proceedings that resulted in proposals for draconian cost allocation rules, the ultimate result was that price cap LECs did not

[47] *See* NASUCA Comments at 98.

[48] *See* § 706, Pub.L. 104-104, Title VII, Feb. 8, 1996, 110 Stat. 153, reproduced in notes under 47 U.S.C. § 157.

[49] NASUCA Comments at 62-66.

deploy video dialtone. Congress deemed the proceeding so detrimental that it took the extraordinary step of terminating the proceeding by statute in Section 302 of the 1996 Act.

The Commission should not make the same mistake here and risk relegating advanced services to the same fate as video dialtone. A much better model for the Commission is the approach it has taken to cost allocation in the context of information services (formerly enhanced services). Specifically, SBC notes that the Commission has never required an allocation of loop costs to information services, such as dial-up Internet access and voice mail. Information services have flourished in this environment. SBC also notes that cable television service providers, the largest providers of high-speed Internet access service, have complete flexibility to recover the costs of their broadband services.

Finally, NASUCA attempts to make an issue of the price cap LECs' position that third-party carriers should pay something when they obtain access to the unbundled high frequency portion of the loop (HFPL) pursuant to a line sharing arrangement. It is true that SBC has argued that carriers should pay for use of the HFPL, but that position has nothing to do with the cost allocation issues raised by NASUCA. The Commission has held that it is appropriate for incumbent LECs to be compensated for providing unbundled access to their network, and SBC is legitimately concerned about letting competitors utilize significant components of its network at no charge. It is unfair to confuse the issue of receiving compensation for complying with the statutory unbundling requirement with the issue of how to allocate costs among a price cap LEC's own services. Moreover, the amount of revenue that SBC receives from line sharing is *de minimis*. As of December 2001, third-party carriers were purchasing the HFPL on fewer than 100,000 lines. The small amount of revenue generated from these line sharing agreements would have no effect on SBC's SLC rates. Also, the Commission will be considering the issue of line sharing in the *Triennial Review* proceeding, and it would be premature for the Commission to address cost allocation issues relating to line sharing at this time.

V. CONCLUSION

For these reasons, the Commission should retain its existing rules, which gradually increase the primary residential and single-line business SLC cap in order to reduce the reliance on implicit subsidies and facilitate SLC deaveraging to reflect cost differences in UNE zones.

Respectfully Submitted,

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